REPORT OF THE
CHIEF LEGISLATIVE ANALYST

DATE: June 19, 2014

TO: Honorable Members of the City Council

FROM: Gerry F. Miller
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Assignment No:14-05-0415

GRAND AVENUE HOTEL AND PARKING REVENUE PARTICIPATION AGREEMENT

SUMMARY

In May 2008, the Council approved actions to provide financial assistance to The Related Companies (Developer) with its effort to construct the first phase of the Grand Avenue Project (Project) (CF# 07-0332), which included a hotel, retail, and housing on Parcel Q. Soon after approval of the agreements for this project, the economic downturn restricted private funding resources and Parcel Q development stopped moving forward.

The Los Angeles Grand Avenue Authority (Authority) continued to engage the Developer, however, to keep the Project alive. They approved other development opportunities such as a housing tower and the Broad Museum on two other parcels in the Project. Then in 2013, the Developer and the Authority were able to agree on a new design for Parcel Q and are now completing negotiations to move that element forward. These plans were formally approved in January 2014 and include a hotel, retail, housing, and commercial uses. Approvals are documented in the Fourth Implementation Agreement to the Development and Disposition Agreement (Fourth DDA, Attachment A).

Motion (Huizar-Price, CF 13-1694, Attachment B) authorized the Chief Legislative Analyst (CLA) to evaluate the feasibility and economic impact of the proposed revisions to the Project. The purpose was to determine whether a feasibility gap exists in the re-designed Parcel Q and how much financial assistance could be provided from the City.

Independent financial analysis (Attachment C) conducted by the City has determined that a feasibility gap of $162.9 million exists in Parcel Q, of which $101.3 million of the gap is due to the hotel. The analysis also determined that Parcel Q will have an economic impact on the City of $407.2 million. Revenue assistance of $47.3 million net present value (npv, at 10%) is recommended, with additional funding of up to $58.2 million npv available contingent upon proportional assistance provided by the County of Los Angeles (County). The previous agreement also included parking occupancy tax (POT) revenue, thus this revised project would also provide for up to $4.7 million npv in POT revenue assistance.

A Memorandum of Understanding (MOU, Attachment D) has been negotiated to describe in detail the terms for the final definitive agreements related to the City's financial support for the Parcel Q development.

On July 17, the CLA received a letter from the County Chief Executive Office indicating that they would not provide financial assistance to support the hotel development. The MOU retains language that would allow for County participation should they revise their decision on the matter.

RECOMMENDATIONS

That the City Council, subject to the approval of the Mayor:

1. Acting as a responsible agency, certify that the Second Addendum to the previously certified Final Environmental Impact Report (EIR) for the Grand Avenue Project-Phase I (Project) consisting of repositioning residential and hotel towers, parking, public plaza, retail/commercial spaces, streetscape and site landscaping by Grand Avenue L.A., LLC, Phase I Developer has been completed in compliance with the California Environmental Quality Act and reflects the independent judgment and analysis of the City, and that the City has reviewed and considered the information contained in the Second Addendum and Final EIR prior to approving the Project; approve the Second Addendum and the proposed revision to the Scope of Development of the Project on Parcel Q to allow for adjustments to the prior approvals consistent with the revised concept design and Project description to facilitate the design and refinement of terms relative to a mixed-use development;

2. Approve the form and substance of the Fourth Amendment to the Disposition and Development Agreement (DDA) among The Los Angeles Grand Avenue Authority, Grand Avenue L.A., LLC, and Grand Avenue M Housing Partners, LLC to implement the revision to the Scope of Development of the Project, and refine other terms;

3. Authorize the Mayor to execute a Memorandum of Understanding between the City of Los Angeles and The Related Companies concerning terms for agreements necessary to provide a revenue participation agreement to close the financing gap in the Grand Avenue Project; and

4. Direct the Chief Legislative Analyst (CLA) and other City departments as necessary to negotiate the final definitive agreements necessary to provide a revenue participation agreement to support the Grand Avenue Project for consideration by Council.

FISCAL IMPACT STATEMENT

There is no fiscal impact on the City General Fund associated with this action.

BACKGROUND

In May 2008, the Council approved actions to provide financial assistance to The Related Companies with its effort to construct a hotel on Parcel Q in the Project. The Project is comprised of four parcels, two owned by the City and two owned by the County. Parcel Q, which is immediately across Grand Avenue from the Walt Disney Concert Hall, was chosen as the key parcel for Phase I development and included a hotel, residential, and retail uses.

Soon after approval of the agreements for this phase of the Project, the economic downturn restricted private funding resources and the project stopped moving forward. The Authority continued to engage the Developer, however, to keep the project alive. Since 2008, the Authority and the Developer agreed to initiate development of a residential tower and the Broad Museum on the City-owned parcels, which originally had been slated for development in later phases of the Project. In 2013, the Developer and the Authority were able to develop a new design for Parcel Q and are now completing negotiations to move that design forward.

Project History

The Authority was created through a Joint Exercise of Powers agreement entered into by the County of Los Angeles (County), The Community Redevelopment Agency of the City of Los Angeles, California (CRA) (which has been succeeded by The Community Redevelopment Agency of the City of Los Angeles, California, a designated local agency, CRA/DLA), and the City of Los Angeles (City) in September 2003. The Authority was charged with facilitating the development of the Project on four parcels of land owned by the CRA and the County, referred to as parcels Q, L, M-2, W-2 in the Bunker Hill Redevelopment Project Area. The Authority conducted a competitive solicitation to identify a developer for the Project and selected The Related Companies.

The Project is intended to create an urban destination on Bunker Hill with an active regional center based around a hotel, entertainment, restaurant, office, and retail uses. This is expected to complement the existing government, cultural, and residential uses in the area. Improving public spaces has also been a focus, including transforming the former County Mall into the 16-acre Grand Park stretching from City Hall to the Music Center, together with numerous streetscape improvement projects.

Parcel Q was identified as the primary development opportunity and designated for development in Phase I of the Project. This component included a hotel, residential, a large plaza to host public events and programming, restaurants and retail, and a grocery store. A significant component of the Parcel Q approvals was a requirement that the Developer pay $50 million for redevelopment of the park located between the various County buildings between Temple and 1st Streets, Grand Avenue and Spring Street, now known as Grand Park. Construction on Parcel Q, including the hotel, was scheduled to commence in 2008 but was halted due to economic conditions.

In compliance with the Project agreements, however, the Developer did make the $50 million payment for, and commenced construction on, improvements to Grand Park. The park was completed and opened in July 2012.

Since 2008, improvements for Parcel L and Parcel M-2 were also approved. The Broad Museum took responsibility for the development of Parcel L, and will complete construction of a contemporary art museum on this site in 2015. The Developer initiated development of Parcel M-2 with a 20-story, 271-unit residential tower with ground floor restaurant and other retail uses. A 24,000 square foot public plaza is planned for the space between Parcel L and Parcel M-2. Parcels Q and W-2 remain undeveloped.

The Project now includes approximately 337,000 square feet of retail space, a 300 room four-star hotel, up to 2,600 housing units comprised of condominium and rental, up to 5,000 parking spaces, the Broad Museum, and the now complete Grand Park.

Parcel Q Design

On January 14, 2014, the Authority approved a revised concept plan and project description for the development of Parcel Q of the Project. Parcel Q will be comprised of two towers built upon a podium that provides 1,350 parking spaces. The program includes approximately 200,000 square feet of dining and entertainment venues, restaurants, retailers and a series of small shops; a public plaza with public programs and amenities; a pavilion for special events; a hotel; approximately 48,000 square feet of office space, and 450 rental and condominium housing units, 20% of which will be affordable to low income households.

The hotel component includes 300 rooms and associated amenities. The Developer has selected sbe, a Los Angeles-based firm, which operates the SLS hotel brand. The SLS Hotel in the Grand Avenue Project is expected to meet or exceed a four-star service level and integrate the hotel amenities with various other retail and restaurant components of the project.

A significant factor in the newly approved Parcel Q design is that Frank Gehry is once again the architect for the project.

Fourth Amended DDA and Environmental Approval

In February 2007, August 2010, May 2012, and December 2012, the Authority approved various actions related to the phased development of the Project, including a First, Second, and Third Amendment to the Disposition and Development Agreement (DDA) between Developer and the Authority which provided for various revisions to the scope of development in accordance with the changes summarized above. The City approved each of these amendments to the DDA.

On May 5, 2014, the Authority transmitted to the City, for Council approval, a proposed Fourth Amendment to the Development and Disposition Agreement, Grand Avenue Project (Fourth DDA, Attachment A). Implementation of the new project design requires amendments to the DDA, to implement terms related to completion of the 2014 Project design concept.

Changes to the Project reflected in the Fourth DDA include a revision to the Schedule of Performance and performance milestones, as well as penalties for failure to meet these milestones. One of these milestones is a requirement that the City and the Developer approve a revised Memorandum of Understanding (MOU) concerning the City's financial support for the project. Failure to meet the milestones presented would result in the Developer losing control of Parcel Q.

Other provisions concern development standards and guidelines, review and approval of plans, drawing, and other documents by the Authority, payment of development fees, and various actions related to community benefits.

The Authority, as well as the County and the CRA/DLA in their governmental capacity have approved the terms of the proposed Fourth Amendment DDA. The City, as a responsible agency under CEQA , is also required to consider and approve the Fourth DDA. The City is not a signatory to the DDA.

City Participation

The City previously approved actions to provide financial assistance for the Parcel Q component of the Project as noted above. Also noted above is a requirement imposed by the Authority in January 2014 that the Developer obtain City approval of a revised MOU to update and amend the previous financial assistance agreements. Motion (Huizar-Price, CF #13-1694, Attachment B) authorized the CLA to evaluate the feasibility of the project and the City revenues that could be generated by the project in an effort to determine whether the City should continue its financial assistance to this project.

The Rosenow Spevacek Group (RSG) was retained to conduct the required analysis. Attachment C is the resultant study, "Grand Avenue Feasibility and Economic Impact Assessment." In this report, RSG evaluates development costs for each element of the project, as well as cash flow that results from the project components. The analysis did not allow for the cost of land acquisition nor costs associated with the project that are attributed to the development and design process prior to the current configuration of the project.

The result of the feasibility analysis is a determination that the project has a feasibility gap of $162.9 million. Of the total feasibility gap, $101.3 million (62%) of the gap is attributed to the hotel component of the project. A significant component of the project cost is related to the architectural design of the Parcel Q buildings. This significant gap indicates that the project is not feasible without financial support from the City.

In addition to feasibility analysis of the project, RSG evaluated the fiscal impact of the project on City. Analysis shows that this project would generate new property tax, sales tax, transient occupancy tax (TOT), parking occupancy tax (POT), utility users tax, business gross receipts tax, and other local revenues estimated at $407.2 million ($138.3 million net present value). Of that total, $186.4 million ($58.2 million npv) is generated from the TOT. These revenues would be net new General Fund revenues for the City.

The City policy when the Project was originally approved was to provide up to 50% of net new revenue generated by the project or 100% of the TOT, whichever is lower. In this case, the net new revenues are $407.2 million, which means that up to 50% of net new revenues, or $203.6 million ($69.2 million npv), could be available. The project is expected to generate $186.4 million ($58.2 million npv) in TOT. Therefore, in keeping with the policy in place when the project was first approved, the Developer is eligible for $186.4 million ($58.2 million npv).

Staff recommends, however, that the support provided be contingent upon proportional participation by the County. The amount recommended for support is discussed below.

Finally, the original Grand Avenue agreement included a provision to provide POT revenues collected in the first ten years, with a provision for those revenues to be repaid from Project parking revenues once the project received the full amount of POT designated. The MOU retains this element, providing a maximum of $7.9 million ($4.7 million npv) within the first ten years of the project. These funds would then be repaid fully to the City from project parking revenues.

County Participation

Unlike other hotel developments considered or approved by the City, the Grand Avenue Project is a unique cooperative development between the City and the County. The concept of a cooperative project is that each of the parties contribute to a solution. As such, the County has a role in providing financial assistance for the project. As shown above, the Project has a feasibility gap of $162.9 million and the City's financial support does not solve that gap.

The draft MOU, therefore, provides that County participation is essential to support this project and that degree of City participation is contingent upon County participation. The City would provide a base amount of funding, but additional funding from the City would be provided only in proportion to its share of the total net new revenue generated for both the City and the County.

The RSG analysis included a review of net new County revenues to be generated for the County by the Grand Avenue Project. It should be noted that County revenues are lower than those generated by the City because the County tax base is limited to new property tax revenues. The County does not benefit from TOT, POT, utility users tax, or other similar types of tax revenues.

RSG estimated that Parcel Q will generate net new revenues of approximately $84.4 million ($32.1 million npv). The total net new revenues received by both the City and the County, then would be a total of $491 million over 25 years. The City portion of those net new revenues is 81% and the County's share is 19%. These proportions, applied to the total TOT generated by Parcel Q, would result in the City providing financial support of $47.3 million npv and the County providing financial support of $10.9 million.

On July 17, the CLA received a letter from the County Chief Executive Office indicating that they would not provide financial assistance to support the hotel development. The MOU retains language that would allow for County participation should they revise their decision on the matter.

Recommended Financial Support

As shown above, Parcel Q has a development financing gap of $162.9 million. The total TOT generated by Parcel Q is $58.2 million. The recommendation, though, is that the City provide an amount that is equivalent to the City's proportion of net new revenue relative to the total net new revenue generated by the City and the County. Thus, the City's participation would be $47.3 million.

The Developer notes that this is not enough to fill the finance gap for Parcel Q and has requested that the City provide additional financial support. Since the City could provide up to $58.2 million and remain in compliance with its policy on economic development of hotels, there is an opportunity for greater participation by the City. It is recommended, however, that the City provide an amount proportional to the County's participation. Therefore, if the County provided more than $10.9 million, the City would provide additional support from the TOT. The final amount provided by the City would be no more than $58.2 million and would be equivalent to 81% of the total City-County financial support for the project.

Memorandum of Understanding

The MOU included as Attachment D to this report provides terms that would serve as the basis for negotiation of the definitive documents necessary to establish the revenue sharing agreement between the City and the Developer. The terms are framed on the information discussed above:

- Revenue participation would range between $138.3 million ($47.3 million npv) and $186.4 million ($58.2 million npv), based on the proportionate share of the City's net new revenues compared to the County's net new revenues at a ratio of 81% City to 19% County.

- City participation will be based upon participation by the County: if the County does not participate, the City will not provide additional funding above $47.3 million in TOT for the project.

- POT will be provided for a term of 10 years or for an amount of $7.9 million ($4.7 million npv), whichever comes first. Once either the term or the amount has been met, the Developer will begin reimbursement of funds received based on net revenues earned by the Project parking facility.

- The hotel will achieve and maintain a four star rating as defined and as determined by the Mobil Travel Guide, or at an equivalent level by an alternative nationally recognized hotel rating service for the duration of the Term.

- The Developer shall provide a Community Benefits Package, including affordable housing, local hiring, living wage requirements, job training and job creation, open space, and inclusion of art elements.

- The Developer shall ensure that the City is designated as the "point of sale" for construction related costs.

<u>Comparison of City Contributions</u>

The table below compares the City contribution to the Project under the previous Parcel Q design and the City contribution under this newly proposed MOU.

Contribution	Previous Design	Proposed Design
TOT contribution	$60.2 million npv	$47.3 million npv
County contribution	$0	Undetermined
POT contribution	$5.5 million npv, with repayment provision	$4.7 million npv , with repayment provision
Additional City TOT contribution	$0	up to $10.9 million npv, contingent upon County contribution in excess of $10.9, and up to $13.5 million npv
Term	20 years	25 years
Hotel Quality Rating	5 Star	Minimum of 4 Star

Attachment A	Fourth Amendment to the Disposition and Development Agreement (Grand Avenue)
Attachment B	Motion (Huizar-Price, CF #13-1694)
Attachment C	"Grand Avenue Feasibility and Economic Impact Assessment"
Attachment D	Memorandum of Understanding